COMMONWEALTH OF MASSACHUSETTS

before the

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Fitchburg Gas & Electric Light Company) D.T.E. 99-66

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REPLY BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,

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March 23, 2001

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INTRODUCTION

Pursuant to the procedural schedule adopted by the Hearing Officer, the Attorney General files this Reply Brief for the limited purpose of responding to certain positions taken in the Initial Brief filed by Fitchburg Gas & Electric Light Company ("Fitchburg" or the "Company") in this proceeding. This Reply Brief is not intended to respond to every argument made or position taken by the Company. Rather, it is intended to respond only to the extent necessary to assist the Department of Telecommunications and Energy ("Department") in its deliberations, i.e., to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the Attorney General in regard to any particular argument, assertion of fact, or statement of position in the Company's Initial Brief should not be interpreted, construed, or treated as assent, acquiescence, or agreement with such argument, assertion, or position.

For the reasons set forth below as well as those in his Initial Brief, the Attorney General submits that the Department should order Fitchburg to make refunds to its customers of the $675,052, with interest, of inventory finance costs recovered through the Cost of Gas Adjustment Clause ("CGAC") since 1987.

OVERVIEW

In its Initial Brief, Fitchburg attempts to confuse the issue and misconstrue the Attorney General's position with arguments that are inapposite to the matter before the Department. The Department already determined that the Company had failed to comply with applicable regulations governing the inclusion of gas inventory finance costs within its Cost of Gas Adjustment Clause ("CGAC") charges since 1987. 220 C.M.R.§ 6:00; Fitchburg Gas & Electric Light Company, D.T.E. 98-51, pp. 20-22 (1998). The Attorney General submits that the record clearly supports the Department's finding in D.T.E. 98-51 and establishes that Fitchburg collected $675,052 in CGAC charges for gas inventory finance costs during the period between

1987 and 1998.(1) The gas inventory financing costs had not been incurred under an approved financing vehicle and, therefore, their inclusion within the CGAC and their collection was in violation of law. D.T.E. 98-51, pp. 21-22. The Department has the authority to and should order refunds in the context of a reconciling charge for which there has been no final approval.

Fitchburg seeks to avoid the inevitable outcome of this proceeding by miscasting the issues before the Department, and then rebutting arguments that have not and need not be made, much less carried to support an order requiring a refund of $675,052 with interest. First, the Company recasts the issue of its compliance with the regulations governing the inclusion of gas inventory finance costs in CGAC charges -- an issue already resolved against the Company by the Department in D.T.E. 98-51 -- into a question of the reasonableness or prudence of its failure to comply with the regulations. Co. Br., pp. 17-30. The Company also attempts to evade the logical implication of its past failure to comply with the applicable regulations -- had it complied with the requirement of Department approval of any financing mechanism, the Company would not have been permitted to include gas inventory finance costs in its CGAC charge without first demonstrating that such costs were not reflected in its base rates -- by arguing that, notwithstanding the Department's finding of non-compliance with the CGAC regulation, it should now be allowed to retain its past collections in the absence of proof of "an identifiable" or "a discernable amount" of gas inventory finance costs in base rates. Id. pp. 9-17,31. Finally, in a desperate attempt to escape the obvious remedy to its past collection of amounts in violation of 220 C.M.R. § 6.06, Fitchburg advances a number of arguments regarding matters outside the scope of this proceeding: an alleged lack of evidence of fraudulent or untoward intent (Id. pp. 31-32, 45-46)(2), the reasonableness of the level of its gas base rates during the period in question (Id. pp. 44-45), the appropriateness of revisiting "final" rate determinations (Id. pp. 34-44), or "the difficulties inherent in defending a claim when evidence has been lost, memories have faded and witnesses have disappeared." Id. pp. 33-34 (internal quotation marks and citation omitted).(3)

These arguments are without merit and should be rejected.

ARGUMENT
THE COMPANY'S ARGUMENTS OVER ITS INTERPRETATION OF 220 C.M.R. § 6.06 ARE IMMATERIAL AS THE DEPARTMENT HAS ALREADY DETERMINED THAT THE COMPANY'S PAST INCLUSION OF GAS INVENTORY COSTS IN ITS CGAC CHARGES DID NOT COMPLY WITH THAT REGULATION

The Company's arguments on brief reflect its view that "there is no substantial evidence that ... it violated any regulations whatsoever," Company Brief, p. 31, and focus on the "reasonableness" or "prudence" of its past interpretation of the Department's requirements for the inclusion of gas inventory costs in CGAC charges. Id. pp. 5-6,9-10, 17-23, 28-30,45-46. This view is without merit and these arguments over the reasonableness or prudence of the Company's conduct are immaterial. The Company cannot ignore the fact that the Department has already found that its inclusion of gas inventory finance costs in its CGAC from 1987 through 1998 had not been in compliance with the terms of the applicable regulations. Fitchburg Gas & Electric Light Company, D.T.E. 98-51, p. 21. The Company never appealed the Commissioners' decision in D.T.E. 98-51 and now may not in this proceeding dispute the issue that it had violated the law. "A final order of an administrative agency in an adjudicatory proceeding, not appealed from and as to which the appeal period has expired, precludes relitigation of the same issues between the same parties, just as would a final judgment of a court of competent jurisdiction." Stowe v. Bologna, 32 Mass. Ap. Ct. 612, 614-615, 592 N.E. 2d 764 (1992) citing United States v. Utah Construction & Mining Company, 384 U.S. 394, 421-422, 86 S. Ct. 1545, 16 L.Ed 2d 642 (1966), Alemeida v. Travelers Insurance Company, 383 Mass. 226, 229-230, 418 N.E. 2d 602 (1981), Davis, Administrative Law Treatise § 21.2 (2d ed. 1983).

The wrongfulness of the Company's behavior has already been conclusively established in D.T.E. 98-51. There is no need for any proof on this fact at this juncture.

Rather, the burden rests with the Company to demonstrate, somehow, that its failure to follow Department regulations regarding the CGAC caused no harm its customers, a conclusion that is not supported by record evidence in this proceeding. See AG Initial Brief, pp. 8-9, 11-14.

Moreover, a utility's violation of the Department's regulations cannot be justified as prudent, reasonable or harmless. Such a policy would "encourage deceptive practices of an increasingly sophisticated variety" in rate setting, a behavior condemned by the Massachusetts Supreme Judicial Court. Lowell Gas Company v. Attorney General, 377 Mass. 37, 49, 385 Mass. 240 (1979). As set fully forth in the Attorney General's Initial Brief and was agreed to by the Company's own expert witness on rate regulation, Dr. Tierney, it is the responsibility of a regulated utility to comply with lawful rules and regulations. .AG Initial Brief, p. 15; Tr. 1, p. 61.

THE COMPANY'S ARGUMENTS ON BRIEF DO NOT EVEN ATTEMPT TO RESPOND TO TIMOTHY NEWHARD'S CONCLUSION THAT HAD IT COMPLIED WITH THE DEPARTMENT'S REGULATIONS, FITCHBURG WOULD NOT HAVE BEEN ALLOWED TO INCLUDE GAS INVENTORY COSTS IN ITS CGAC

On brief, the Company argues that notwithstanding any violation of the Department's regulations, it should not be required to refund any of its wrongful CGAC collections in the absence of proof of "an identifiable" or "a discernable amount" of gas inventory finance costs in base rates. Id. pp. 9-17,31. In essence, it argues that the Attorney General, indeed, the Attorney General and the Department, must "demonstrate that there was ... [an identifiable or discernable amount] of gas inventory in rate base." Id. pp. 9, 17. This, of course, ignores the obvious point that Mr. Newhard explained,

had the Company sought the Department's approval for a financing vehicle, prior to including gas inventory financing costs in its CGAC, the Department would have prohibited the inclusion of those costs in the Company's CGAC , until an appropriate downward adjustment had been made to the Company's existing base rates.

Exh. AG-1, p. 4. In these circumstances, then, the Company's plaints that "the idea that costs can be tracked exactly through a revenue requirement ... is an economic fiction and is not substantiated in regulatory policy or law" and that the 1984 rate case settlement negated any ability to track costs are without merit. Its violation established, it is the Company that must demonstrate that notwithstanding that violation it would have been allowed to collect the same CGAC charges had it complied with the Department's regulations.(4) In essence, in this proceeding, the Department is examining an issue reserved in its earlier tentative approvals of the Company's CGAC filings and it is the Company that bears the burden of proof on the question of whether particular costs are appropriately included within its CGAC charge. As explained supra, the law of the case is that the gas inventory finance costs were not appropriate for inclusion with the CGAC. Therefore, it is the Company's burden to demonstrate it should nevertheless be allowed to retain those charges as it those costs were not then reflected in base rates. The Attorney General submits that the Company could not make that demonstration in 1987 and it has not made it now.

The Company also cannot seek refuge in the Department's CGAC "approvals." The Department's action was tentative, not final. The Department was express that it may "require the Company to refund to its customers any amounts that are found by the Department to be the result of imprudent company action in the event that subsequent review of the Company's filings or any other relevant information filed with the Department requires such changes"(5) See, e.g., Exhibit AG-1-7, Oct. 31, 1996. Clearly such a situation exists in this case.

SUBSTANTIAL EVIDENCE DEMONSTRATES FITCHBURG OVER-COLLECTED INVENTORY FINANCE COSTS

Fitchburg maintains that there is "no substantial evidence" that an over-collection of gas inventory finance costs occurred, while attempting to shift the burden to the

Department and the Attorney General to show that gas inventory finance costs were not in base rates. Co. Br. pp. 30-32. The Company also argues that the base rates in effect during the period in question were established as the result of a settlement which did not provide for a stipulated amount for any item in rate base or in the cost of service, and therefore, the Department cannot determine the amount of gas inventory finance cost that were in base rates. Id. pp. 10-11. As will be discussed below, both of these arguements fail and must be rejected by the Department.

First, as is discussed supra, as the Department has already determined, it is the Company's burden in this case to show that it is not over-collecting its gas inventory finance costs. In the Order in D.T.E. 98-51, the Department found that gas inventory finance costs were being recovered through the CGAC and that those costs were included as a cost of service item in its last base rate case. Therefore, the burden is upon the Company to show that these costs were not being recovered through base rates.

Second, the fact that base rates were established as the result of a settlement which does not stipulate the amount of any costs does not mean that those costs are not being recovered. The fact is that the Department, as well as the Company always considered those costs to be in base rates. Basic ratemaking principles assume that rates are established so that a utility has the opportunity to recover all of its costs to provide service. As the Company readily admits "a cost study for any company begins with including all of its costs." Co. Br. p. 32. The Company also agrees that the Department as well as the other parties assessed the revenue requirement proposed by the settlement in light of the test year cost of service, other information filed in the case, and the Department's own precedent which included gas inventory finance costs in base rates. Co. Br. p. 14 and Tr. II, pp. 252-254. The Company included these costs in its costs of service in D.P.U. 1214, and D.P.U. 84-145. Therefore, the only conclusion can be that the gas inventory finance costs were included in the determination of the resulting rates.

A determination of the exact dollar amount contained in base rates is unnecessary and irrelevant.(6) The Company concedes that, although there is no expectation or desire to "track" the particular dollars spent in the rate year or any subsequent year against the test year cost of service amount, there is an expectation that there is a "representative" level of costs in the test year cost of service used to establish an overall rate level. Id. p. 11. Furthermore, as Mr. Newhard testified, the exact dollar amount recovered through base rates is unimportant, since the Company's base rates were established both in D.P.U. 1214 and D.P.U. 84-145 allowing it the opportunity to recover all of its inventory financing costs whatever the dollar amount of costs might have been, and therefore any dollar amount recovered simultaneously through the CGAC would be per se an over-collection that must be returned to customers.(7) Therefore, the Department must find that all gas inventory finance cost dollars collected by Company through the CGAC were over-collected.

THE DEPARTMENT MUST MAKE CUSTOMERS WHOLE FOR THE LOSS OF USE OF THEIR FUNDS

The Company claims that the Attorney General's request for a carrying charge rate on unreturned funds based on customers' opportunity cost results in the Company paying a "penalty" for its actions. Co.Br., p. 33. However, the Attorney General is not seeking to extract any penalty from the Company, but rather, he is only requesting that customers be made whole. Customers have been economically harmed. It therefore is equitable for the Department to order the Company to refund the inventory finance costs with a return based on the customers opportunity cost for those funds. To refund at the Bank of Boston prime rate as suggested by Fitchburg (Co. Br., p. 33), a rate which is lower than the Company's cost of capital, still allows it to profit by violating the Department's regulations. The Attorney General submits that refunding at a rate equal to customer opportunity costs is appropriate based on the record in this matter.

THE REASONABLENESS OF FITCHBURG'S BASE RATES IS NOT AN ISSUE

Fitchburg argues that its gas division rates have been just and reasonable and during the period in question earned less than its 1984 authorized return and also less than the 11% return recently allowed in its 1998 rate case. Co. Br., p. 44.

However, the reasonableness of the Company's base rates is not at issue here, rather it is the Company's CGAC that is under investigation. Fitchburg has had the use of the inventory finance funds since 1987 and the fact that return of the funds creates some hardship to stockholders does not diminish the right of customers to the return of funds improperly collected.

Even if the rate of return calculations were relevant to this investigation, the Company's calculation of its returns over the period in question are of no evidentiary value. As Ms. Asbury conceded, the revenues used for the calculation were not weather-normalized and the calculation does not conform to the methodology of the Department. Tr.II, p. 257. Ms. Asbury has also concede that her testimony regarding the financial impact on Fitchburg was not made from a basis of financial expertise. Tr. II, p. 279.

THE DEPARTMENT HAS THE AUTHORITY TO ORDER REFUNDS OF COSTS RECOVERED UNDER THE CGAC
The Company argues at length that the Department is completely powerless to fashion a remedy for the over collections citing numerous cases on retroactive ratemaking and the attendant constitutional takings concerns. Co. Br., pp. 37-44. But the Massachusetts decisions relied upon by the Company, principally Lowell Gas Company v. Attorney General, 377 Mass. 37, 385 Mass. 37 (1979) and Boston Edison Company v. Department of Public Utilities, 375 Mass. 1, 375 N.E. 2d 305 (1978) are clearly distinguishable from the facts of this proceeding. These cases were decided before the 1987 promulgation of the the CGAC regulations found at 220 C.M.R. § 6.00 et seq., and therefore are not binding authority.

Through these regulations, which are reconciling in nature, the Department has established a method for appropriately collecting the costs of gas inventory finance charges and expressly granted only "tentative" approval of the requested Gas Adjustment Factor ("GAF") while specifically reserving the right "to require the Company" to issue customer "refunds." Exh. FGE-3 (2/14/01), Attachment B (October 31, 1989 letter); AG Br., p.17. Fitchburg never appealed, sought reconsideration or otherwise challenged these tentative approvals. It is far too late now to shake the talisman of "retroactive rate making" to ward off the conclusion that the Company fully accepted the Department's straightforward conditions for inventory finance cost recovery. Factually, as well as legally, the case now before the Department differs materially from the Lowell Gas family of cases.

POLICY IMPLICATIONS DO NOT REQUIRE A REDUCTION IN THE LEVEL OF REFUNDS
The Company argues that the Department should "refrain" from ordering reparations based on events that occurred over 16 years ago. Co. Br., pp. 33-34. Fitchburg maintains that public policy should limit the time within which liability can attach to its actions. Therefore, according to the Company, the Department should not require such reparations for the entire period in which inventory finance costs were included in the CGAC, but instead the time period should be shorter in recognition of the purpose behind legislatively created statutes of limitations. Co. Br., p. 34.

The Attorney General submits that sound regulatory policy does not support the arbitrary creation of a cut-off date under the circumstances of this case. A shortened time span will only encourage deceptive regulatory practices and the convenient loss of both memory and documentary evidence, all to the potential detriment of ratepayers.

CONCLUSION
For all of the foregoing reasons, the Attorney General respectfully urges the Department to order the Company to make refunds to its customers of the $675,052 with interest computed from the time of the wrongful charges.

Respectfully submitted,

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Dated: March 23, 2001

1. While the Company does not agree that the amounts in question should be considered to be overcharges, there is no dispute regarding the amount of the charges in question. Compare Exh. AG-1, p. 3 with Exh. FGE-3, p. 8.

2. Issues relating to fraud are not relevant to the resolution of this matter, however the Company's inclusion of a "0" for the line entry for "Inventory Finance Charges" in the CGAC, when in fact the number was not 0, is consistent with concealment. See Exh. AG-1 2/14/01, pp. 3-5.

3. In addition, despite the Hearing Officer's ruling excluding the notes of former employees with no decision-making authority or power or delegated authority from the Department from this proceeding, Fitchburg makes several reference to conversations its employees had with the Department Staff to advance the notion that the Department, through its Staff, approved the collection of finance charges in the CGAC. Co. Br., pp. 4, 21, 25, and 26. As a general evidentiary rule, when the circumstances of a case are such that a party would be expected to call a witness who is available to testify but the witness is not called, a fact finder may be permitted to infer that the witness's testimony would have been adverse to that party. Commonwealth v. Franklin, 366 Mass. 284, 292-293, 318 N.E.2d 469 (1974). Here, the Company has claimed that it received verbal approval by Department staff of its method of including the inventory finance charges in the CGAC, Co. Br. at p. 25, but has failed to call current or former staff to testify before the record closed in this case. Such a reluctance to call a potentially exculpatory witness is particularly glaring considering that one of the identified staff, still works at the Department. In these circumstances, it is reasonable to infer that the named

witnesses would not have corroborated the Company's version of events.

4. Indeed, it is worth observation that the Company did not dispute the Attorney General's earlier observation that it was on the basis of the fact that gas inventory had been excluded from rate base in D.T.E. 98-51 that the Department granted the Company an exception from the requirements 220 C.M.R. 6.06.

5. The Department can change the GAF at any time. 220 C.M.R. 6:12 (3).

6. Fitchburg had the opportunity to exculpate itself by producing evidence that expressly demonstrated whether or not interest on gas inventory was included in its base rate. After all, such information is particularly within the Company's knowledge. Rather than produce those facts, if they exist, the Company instead shrouded its rate components in secrecy by arguing, as a legal matter, that the rate settlement bars scrutiny of the issue.

7. The Company argues at great length the settled base rate and retroactivity principles regarding the supposed modification of those rates, even though the Attorney General only seeks the return of the $675,052 illegally taken through the CGAC with appropriate carrying charges. Still, the $675,052 CGAC amount is conservatively low and pales in comparison to the $1,507,137 (or $4,326,823 with carrying charges at 15 percent) gas inventory finance charge amount that could be imputed to base rates from the Company's filing in D.P.U. 84-145. Exh. RR-12. Therefore, assuming that the $675,052 is closer to the Company's real out-of-pocket outlay for gas inventory finance costs, requiring the return of only that amount would still put the Company's imputed base rate recovery well in excess of its actual costs.